

DIVISION OF REVENUE

TECHNICAL INFORMATION MEMORANDUM 2000-06

DATE: December 28, 2000

SUBJECT: Legislation passed during the Second Session of the 140th Delaware General Assembly.

SUMMARY:

During the Second Regular Session of the 140th General Assembly, ended June 30, 2000 ten bills were enacted of interest to or with an impact on taxpayers and the Department of Finance.

The subjects range from reorganizing the statutes relating to the treatment of pass-through entities and traditional trusts to increasing the threshold for assessing penalty on the underpayment of estimated personal income tax.

The bills may be viewed through the Delaware Division of Revenue web site at [<http://www.state.de.us/revenue>], by clicking on "Technical Memos, Other links, Press releases, etc.", then "140th General Assembly Bill Tracking".

This year's legislation is divided into three categories for purposes of description: (I) legislation implementing broad policy changes that affect businesses and individuals, but have no impact on tax rates or revenues, (II) legislation effecting tax reductions and credits for individuals and businesses and (III) a Resolution of the House of Representatives relating to abandoned property.

This memorandum is intended for general notification and explanation of recently enacted Delaware law and should not be relied upon exclusively in any pending or future audit or judicial review of an individual taxpayer or transaction. Taxpayers are advised to consult the particular bill, the Delaware Code, or Delaware regulations in all matters conflicting with any part of this memorandum.

Taxpayers with general questions about the application of Delaware law and procedures may call the Division of Revenue help line at (302) 577-8200, or visit the Division's website at [<http://www.state.de.us/revenue>] where information about tax topics and links to phone numbers for other information may be found.

I. Legislation implementing broad policy changes that affect businesses and individuals, but have no impact on tax rates or revenues.

House Bill No. 651

A. OVERVIEW:

This Bill is a comprehensive reorganization of the principles of treatment of pass-through entities under existing Delaware tax statutes and administrative interpretations. It is the intention of this Bill to largely reflect existing Delaware statutes or, where existing Delaware statutes have not been determinative of an issue, interpretations by the Delaware Division of Revenue in its regulations, revenue rulings, private letter rulings and tax information memoranda.

The Bill creates a new Chapter 16 of Title 30 of the Delaware Code. Chapter 16 is divided into three subchapters dealing with 1. definitions and general provisions, 2. taxation of pass-through entities and their members, and 3. taxation of estates, trusts and their beneficiaries, respectively. Subchapter III, in particular, is intended to incorporate in all material respects the existing law relating to the taxation of estates, traditional asset protection and estate planning trusts, and their beneficiaries as presently exists in Sections 1131 through 1142 of Title 30 of the Delaware Code.

B. SECTION-BY-SECTION SYNOPSES

Section 1. Section 1 of the Bill contains the bulk of the code reorganization and new Chapter 16, Sections 1601 through 1640.

Subchapter I.

Section 1601 contains definitions related to Chapter 16, many of which follow existing statutes and may affect provisions in other sections of Title 30. The definitions distinguish a pass-through entity from a trust, estate, and other forms of business organizations.

Sections 1602, 1603 and 1604 adopt provisions of existing law relating to the taxable year, accounting methods, and adjustments for pass-through entities.

Section 1605 states the duty, time, and separate notice requirements for tax returns of pass-through entities, estates, trusts and their members or beneficiaries.

Subchapter II.

Section 1621 provides that members, not pass-through entities, are liable for taxes imposed by Chapters 11 or 19 of Title 30 of the Delaware Code relating to individuals and corporations. However an entity conducting business in this State, and not its members, is liable for business license and excise taxes. The exemption from income tax for Subchapter S corporations does not apply to a Subchapter S-Corporation's duty under Title 30, Del. C. § 1158 to pay tax on behalf of its non-resident shareholders.

Section 1622 provides that all items of income, gain, loss or deduction incurred by a pass-

through entity shall be passed through to its members and have the same character in the hands of the members as it has for federal income tax purposes. The section also contains provisions to preclude multi-state businesses from allocating items of income, gain, loss or deduction between Delaware and other states in an arbitrary manner for the purpose of distorting the Delaware taxable income of its members or without substantial economic effect.

Section 1623 provides special rules for determining the state in which items of income, gain, loss or deduction of a multi-state pass-through entity are allocated or apportioned among members who are corporations or non-resident individuals.

Subchapter III.

Subchapter III, containing Sections 1631 through 1640 is materially the same as existing Title 30, Sections 1131 through 1142 relating to estates, trusts and beneficiaries, except that sections 1135 and 1136 are definitions which are treated at Section 1601 and are repealed.

Section 2 of the Bill enacts Section 1624 of Title 30 of the Delaware Code providing special rules for certain tax credits of pass-through entities. In general, tax credits allowed by Chapter 18 and Chapter 20 of Title 30 are passed through a pass-through entity to its members. Initial and continuing qualification for the tax credit is determined by the activities and investments of the entity. Limitations on credits are determined at two tiers: (a) in the case of a limitation based on amounts invested, or total allowable credits, or the number of persons employed, or all of these, at the entity level, and (b) in the case of limitations on the total amount of tax against which such credit may be applied, at the member level. Special Rules deal with the allocation of the investment tax credit among members of certain aggregates of pass-through entities.

Section 3 of the Bill amends § 1124(a) of Title 30 of the Delaware Code to conform cross-references to Chapter 16.

Section 4 of the Bill amends the definition of entities permitted tax credits under Chapter 20, Title 30 of the Delaware Code to include pass-through entities.

Section 5 of the Bill deletes § 2023, Title 30 of the Delaware Code relating to issues addressed in Section 2 of the Act.

Section 6 of the Bill amends § 2024, Title 30 of the Delaware Code relating to allowance of Chapter 20 business tax credits for individuals as well as corporations so as to reflect the determination under chapter 16 of the pass through of such credits to individuals. For completeness, the section also reflects the operation of § 2070, Research and Development Credits, as it applies to individual income tax returns.

Section 7 of the Bill deletes multiple sections of Chapter 11, Title 30 of the Delaware Code addressed in new Chapter 16, Section 1622.

House Bill No. 514

House Bill No. 514 establishes a new “Delaware Diabetes Education Fund” and

implements the procedure for individuals to designate a part of their personal income tax refund or contribute money to the fund. Space will be provided on the Delaware personal income tax return to designate a contribution.

Senate Bill No. 354

Senate Bill No. 354 amends Title 30 DeL.C. § 1169(a) by increasing from \$100 to \$400 the threshold above which an individual must make a declaration of and pay estimated tax.

House Bill No. 313

House Bill No. 313 amends the Tobacco Product Tax, Title 30 DeL.C. , Chapter 53, by adding new § 5346 prohibiting the sale of cigarettes in packages violating federal labeling, export, import, and trademark or copyright laws.

Senate Bill No. 314

Senate Bill No. 314 amends Title 12 DeL.C. §§ 1905 and 1912 relating to clearing title to real estate of decedents when no formal probate is initiated. Under amended § 1905, when no letters testamentary or of administration are required for an estate, and real property passes to any person by joint tenancy or tenancy by the entireties, an affidavit must be filed in the office of the Register of Wills setting forth a description of the real property and the surviving joint owner(s). Whenever such property is subject to Delaware estate tax, the Register of Wills is required to make an entry to that effect in the Inheritance and Succession Docket.

Senate Bill No. 356

Senate Bill No. 356 reauthorizes the Hazardous Substance Cleanup Act, including the Hazardous Substance Cleanup Fund under 7 Del. C. Chapter 91 through 2011.

Legislation effecting tax reductions and credits for individuals and businesses.

House Bill No. 614

Under Title 30 DeL.C. Chapter 29, certain wholesale transactions and sales of certain products are excluded from the definition of taxable gross receipts for purposes of the Retail and Wholesale Merchants' License Requirements and Taxes. House Bill No. 614 amends § 2901(b) (viii) by (A) clarifying existing law to include sales of pharmaceutical ingredients between a Delaware commercially domiciled manufacturer and a related, non-U.S. entity, regardless of the form of business entity, and (B) establishing an additional exclusion for gross receipts from the sale of finished ethical pharmaceutical products between such related entities.

Senate Bill No. 75

Senate Bill No 75 amends Title 4 DeL.C. § 582 by expanding to all forms of alcoholic liquors the existing exclusion from tax on sales of beer by importers or wholesalers to an instrumentality of the armed forces of the United States.

Senate Bill No. 304

Senate Bill No 304 extends by five years the sunset of the "Blue Collar Jobs" credit program (Title 30 DeL.C., Chapter 20, Subchapter II; Tax Credit and License Fee Reduction for Creation of Employment and Qualified Investment in Business Facilities), until January 1, 2007.

House Bill No. 551

House Bill No 551 amends Title 30 DeL.C. § 5401(1) by adding an exemption from the Delaware Realty Transfer Tax for transfers of real property between siblings, half-siblings and step-siblings.

III. Resolution of the House of Representatives relating to abandoned property.

House Resolution No. 96

House Resolution No. 96 authorizes the appointment of a committee to review changes to the escheat laws of this State proposed by House Bill No. 617 and to make a written report of its findings to the Governor and the General Assembly by December 31, 2000.

Patrick Carter

Acting Director of Revenue